TEN-YEAR INDUSTRIAL PROPERTY TAX EXEMPTION PROGRAM

FINDING: During the course of its deliberations, the SCOFA committee heard the results of a study conducted on the ten-year industrial property tax exemption program. This study revealed that while new locations produce more jobs, investment, and pay more state and local sales taxes, the program attracts few new facilities. Other findings showed that exemptions were concentrated in certain areas and industries, and that the program does not foster the growth of high-tech industry.

Vigorous economic performance and the perception of widespread prosperity in the United States are almost taken for granted now. However, while most states continue to experience sustained (although slowed) economic growth, Louisiana has entered a precarious time. After running six straight years of surpluses, Governor Foster was forced to issue several executive orders in 1999, 2000, and 2001 to head off potential budgetary deficits at the end of fiscal years 1998-99, 1999-00 2000-1001. This performance highlights the importance of government interventions aimed at increasing the state's economic viability. One economic development incentive program, and the focus of this presentation, is the ten-year industrial property tax exemption.

Specifically, the program is targeted at manufacturing establishments as defined in the state constitution to be an existing plant or establishment "which engages in the business of working raw materials into wares." (Article VII, § 21) A House Fiscal Division study examined 5,851 of the 6,038 applications approved between 1990 and 1999. (*See Appendix pp. 9-19)*

Descriptive statistics on the exemptions that were studied draw a picture of the areas of the state that are most impacted by the program, which industries are more likely to use the program, and what types of projects are likely to be funded through the exemption. Overall, the 5,851 applications studied totaled $19.2 billion in manufacturing investment, $2.6 billion in tax relief, and created 304,335 jobs, over 40,000 of which were permanent jobs. On average, each project received over $451,605 in tax relief and generated approximately $126,313 in sales taxes, created 52 jobs (7 of which were permanent), and attracted over $3.3 million in manufacturing investment.

The major findings presented below show that:

- While on average, new locations produce more jobs, investment, and pay more state and local sales taxes, the program attracts few new facilities.
- Exemptions are concentrated in certain areas and industries.
- The program does not foster the growth of high-tech industry.

These findings and others which arose through the committee discussions form the basis of the options presented on this program.

<u>OPTION 1</u>: Ensure greater accountability of those granted exemptions especially related to job creation, length of stay in the state, and the types of projects that are funded.

This could entail instituting a job creation requirement and the development of other performance criteria and a system for the systematic review of performance over the period of the exemption. Such a system would involve the collection of more detailed data and the submission of periodic reports from the company. It could also involve instituting "clawback" provisions if companies do not maintain a certain level of investment or employment. The state may also conduct more periodic audits to assess whether the company actually created and retained the jobs over the exemption period. Examples of accountability provisions included in tax incentive programs in other states are provided in the Appendix. *(See Appendix pp. 21-30)*

Background And Description: The constitutional provision creating the program does not create an entitlement. The constitution states that:

> "Notwithstanding any contrary provision of this Section, the State Board of Commerce and Industry or its successor, with the approval of the governor, ***may*** enter into contracts for the exemption from ad valorem taxes of a new manufacturing establishment or an addition to an existing manufacturing establishment, on such terms and conditions as the board, with the approval of the governor, deems in the best interest of the state.
>
> The exemption shall be for an initial term of no more than five calendar years, and ***may*** be renewed for an additional five years. All property exempted shall be listed on the assessment rolls and submitted to the Louisiana Tax Commission or its successor, but no taxes shall be collected thereon during the period of exemption.
>
> The terms "manufacturing establishment" and "addition" as used herein mean a new plant or establishment or an addition or additions to any existing plant or establishment which engages in the business of working raw materials into wares suitable for use or which gives new shapes, qualities or combinations to matter which already has gone through some artificial process. (Article VII, § 21(F))"

The provision of industrial tax exemptions is to be based on what the Board of Commerce and Industry deems is in the state's best interest. The state, namely the Department of Economic Development, has the authority to promulgate rules governing the operation of the program. These rules can be modified to maximize the benefit to the state for each exemption that is granted. However, current regulations governing the program make no attempt to define what is in the state's best interest, or to maximize the benefit to the state. Moreover, inspection audits are conducted only to verify that the construction took place and that the facility was built.

Estimated Fiscal Impact: Unknown

Action Required To Implement: Promulgation of rules at minimum.

<u>OPTION 2:</u> Evaluate the category "miscellaneous capital additions" and the feasibility of shortening the exemption period for this category, in order to maximize benefit to the state and minimize costs. Explore/investigate the possibility of restructuring the program in order to attract more new locations.

Background And Description: The study conducted on exemptions awarded between 1990 and 1999 showed that only 5% or 292 applications approved during the 1990s were for new plant locations. The bulk of applications, 62% or 3633 were for "miscellaneous capital additions (MCAs)."

The rules define an MCA to be "an accumulation, over a 12-month period of small capital outlay purchases totaling a maximum of $5,000,000". (LAC 13: 505 [6]) Applications for this exemption type are submitted after expenditures occur. Small capital outlay purchases include anything that remains on the plant-site, such as valves, heat exchangers, phone lines, railroad tracks, piping, etc. There is no limitation on the number of MCA applications a company can file.

Applications for miscellaneous capital had a low return rate over the 10-year exemption period when compared to new locations and expansion projects in terms of permanent jobs (12,196 total and 3 on average), investment ($6.1 billion total and $1.7 million on average) or sales taxes paid ($229 million total and $63,036 on average). Moreover, the low average amount of tax relief or $155,269 over the life of the exemption, raises doubts about whether the exemption was a deciding factor in the company's decision to add capital to its operations. However, the average tax relief awarded to a particular company could be significantly higher to the extent that certain companies file several MCAs at the same time period.

Given the above discussion, there is some question as to whether this type of application provides a real incentive. Specifically, if a particular company did not receive this exemption would they realistically leave the state? Since many of the firms that have filed an MCA are receiving exemptions for expansions or new locations, this does not seem to be a real threat. In addition, the state needs to determine whether such an exemption is worth the amount of investment by conducting real cost benefit analyses on each project. Lastly, the small amount of new locations over the 10-year study period raises questions about the program's effectiveness in attracting new companies. Changes in the regional and global economies call for more innovative tools that better address business needs and that would provide more effective in attracting new facilities.

Estimated Fiscal Impact: Unknown

Action Required To Implement: Promulgation of rules

<u>OPTION 3</u>: Reevaluate the ten-year tax industrial property tax exemption program in light of current economic development priorities. Reevaluate the necessity of granting automatic five-year extensions of the exemptions.

Background And Description: Companies such as Fruit of the Loom have received incentives and, within a few years laid off thousands of employees. Assessments of a company's financial stability and market potential should be conducted to head off similar situations. This will help assess the company's viability and whether they will continue to operate and provide economic benefit to the state during the length of the exemption period.

The state should also investigate the possibility of giving varying levels and types of exemptions for different projects according to their merit and attractiveness. For example, new locations would receive a greater exemption than other types of expansions. Another example would be to grant a 100% exemption in the first year and a lesser percentage in the out years.

These approaches address the concern that companies may leave after having been granted an exemption, before their time period is up. It also would reward companies that are more likely to remain in the state when their exemption period is over.

Estimated Fiscal Impact: Unknown

Action Required To Implement: Promulgation of rules at minimum

<u>OPTION 4:</u> Develop a more targeted incentive program that would focus on developing the state's high-tech industry.

Background And Description: The American Electronics Association (AEA) uses 45 separate four-digit Standard Industrial Classification (SIC) codes to define high-technology industries. AEA's definition consists of codes that fall into three main categories—high-tech manufacturing, communications services and software and computer-related services. According to this definition, between 1990 and 1999 only 70 applications in "high-technology" industries were approved. These applications generated over $64.7 million in investments, were awarded $11.1 million in tax exemptions and created 983 new jobs, almost half of which were permanent.

The ten-year industrial tax exemption program was not designed to enhance the growth of the high-tech sector, largely because most high-tech businesses provide services. The goals of the State's 20-year comprehensive plan for economic development, Vision 2020, describe the move towards diversifying the state economy. In light of these goals, the state needs an effective incentive program that would allow the growth of such firms.

Estimated Fiscal Impact: Unknown

Action Required To Implement: Promulgation of rules at minimum or statutory provisions.